

Proposed Legislative Changes to Ensure Premium Tax Applies to Capitation Payments Received by Prepaid Health Plans

Session Law 2018-49, Section 8.(c)



Report to

**The Joint Legislative Oversight Committee on
Medicaid and NC Health Choice**

By

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Introduction

Session Law (S.L.) 2018-49, Section 8.(c), see *Attachment A*, requires the North Carolina Department of Health and Human Services (DHHS), in consultation with the Department of Revenue, to submit a report by October 1, 2018, to the Joint Legislative Oversight Committee on Medicaid and NC Health Choice to include:

- (1) proposed legislative changes necessary to implement a premium tax on capitation payments received by Prepaid Health Plans (PHPs), in the same manner in which the tax is applied to the gross premiums from business done in the State for all other health care plans and contracts of insurance provided by insurers or health maintenance organizations subject to the tax;
- (2) assurances that the proposed legislative changes do not violate federal Medicaid laws or regulations; and an
- (3) estimate of the amount of increase in revenue that is anticipated as a result of the proposed legislative changes and any proposed uses for the revenue.

This report, developed in consultation with the North Carolina Department of Revenue, meets all requirements of S.L. 2018-49, Section 8.(c). It details the proposed legislative changes, analyzes and provides assurances of compliance with federal Medicaid laws and regulations, and discusses the expected revenue.

1. Proposed Legislative Changes

The text of proposed legislative changes is set out in *Attachment B*. This language: (1) adds PHPs as an entity subject to the tax levied under G.S. 105-228.5; and (2) credits all proceeds collected from PHPs to a fund for the support of the Medicaid and NC Health Choice programs, used only by DHHS, pursuant to an appropriation by the General Assembly.

2. Compliance with Federal Law and Regulations

North Carolina's proposal to impose the State's existing premium tax on PHPs complies with federal requirements. Since only a portion of the total premium tax applies to health insurance, the premium tax would not be considered a healthcare-related tax. As a result, none of the federal requirements applicable to healthcare-related taxes would apply.

Federal rules impose various requirements on healthcare-related taxes that are used to fund the non-federal share of Medicaid programs. To be considered a healthcare-related tax, 85% or more of the incidence of the tax must fall on one or more of the nineteen classes of healthcare providers set out in federal regulations.¹ Managed care organizations are one of the classes of healthcare providers subject to the Medicaid provider tax rules. The rules define managed care organizations as "including health maintenance organizations [and] preferred provider organizations."² PHPs are a type of managed care organization. Thus, if 85% of the incidence of the premium tax falls on

¹ 42 C.F.R. § 433.55; 42 C.F.R. § 433.56.

² 42 C.F.R. § 433.56.

PHPs and other managed care organizations, the premium tax would be considered a healthcare-related tax. By contrast, if more than 15% of the premium tax would be paid by other types of insurers, such as life insurers or property and casualty insurers (e.g., automobile, homeowners), then the tax would not be considered a healthcare-related tax. If a tax is not healthcare-related under this standard, none of the requirements specifically related to healthcare-related taxes—namely, the requirements that the tax be broad-based and uniform and that taxpayers not be held harmless³—apply.

Based on an analysis of receipts under the premium tax, all health insurance (regardless of whether it falls under the definition of “managed care” in the federal healthcare-related tax rules) would account for less than **half** of total insurance premiums written in North Carolina *after* the tax is applied to PHPs and, thus, would account for less than **50%** of revenue under the premium tax.⁴ This conservative estimate is far below the 85% threshold needed to qualify as a healthcare-related tax under federal rules. Accordingly, federal requirements related to healthcare-related taxes do not apply to the premium tax that DHHS is proposing to impose on the PHPs.

There have been cases where other states were prohibited from including Medicaid managed care plans under broader state taxes, prompting the Centers for Medicare and Medicaid Services (CMS) to issue guidance.⁵ However, North Carolina’s proposal to include PHPs in the premium tax differs considerably from those prohibited taxes. In those other states, the issue was that *only* Medicaid managed care organizations were subjected to a broader state tax, such as a sales tax or premium tax, while excluding other types of commercial managed care organizations. For example, if North Carolina’s premium tax applied to the PHPs, but excluded other managed care organizations that did not serve the Medicaid population, CMS might conclude that this arrangement violated federal law. Since both managed care organizations insuring commercial lives and the PHPs insuring Medicaid lives will all be subject to the same tax, there is little basis for CMS to conclude that this arrangement is impermissible.

³ See 42 C.F.R. § 433.68 for the requirements applicable to healthcare-related taxes.

⁴ State Insurance Regulation in North Carolina: Key Facts and Market Trends, NAIC, (2017) (available at: https://www.naic.org/state_report_cards/report_card_nc.pdf). Assumes PHP revenue would add \$9 billion in health-related premium revenue.

⁵ State Medicaid Director Letter, SHO # 14-001, Re: Health Care-Related Taxes, (July 25, 2014) (available at <https://www.medicaid.gov/Federal-Policy-Guidance/downloads/SHO-14-001.pdf>).

3. Revenue Estimate and Proposed Use of Proceeds

DHHS estimates that applying the premium tax levied under G.S. 105-228.5 to capitation payments received by PHPs would generate the following amount of new revenue⁶ for each tax year:

- *2019 Tax Year (collected in 2020): \$ 5 M*
- *2020 Tax Year (collected in 2021): \$ 116 M*
- *2021 Tax Year (collected in 2022): \$ 155 M*
- *2022 Tax Year (collected in 2023): \$ 190 M*

These estimates assume the following schedule for managed care implementation:

- November 1, 2019: enrollment in Standard Plans for two of six regions (estimate assumes one-third of Standard Plan capitation payments)
- February 2, 2019: enrollment in Standard Plans for remaining four regions
- July 1, 2021: enrollment in Behavioral Health / Intellectual and Developmental Disability Tailored Plans

The premium tax owed is calculated each March based on premiums received in the prior calendar year. Since managed care is slated to begin in only two regions in November 2019, the premium tax paid beginning in March 2020 reflects only the premiums paid in November and December 2019.

The Department plans to use receipts from the premium tax to fund North Carolina Medicaid Managed Care. Premium tax revenue will be incorporated into the State's 7-year Medicaid forecast as required by Section 11H.9 of S.L. 2018-5.

⁶ This estimate reflects only the premium tax amount, not the insurance regulatory charge imposed under G.S. 58-6-25 for entities subject to the premium tax. DHHS estimates the insurance regulatory charge for PHPs would be as follows:

- 2019 Tax Year: \$ 0.2 M
- 2020 Tax Year: \$ 7 M
- 2021 Tax Year: \$ 9 M
- 2022 Tax Year: \$ 11 M

Attachment A: S.L. 2018-49, Section 8.(a) and 8.(c)

SECTION 8.(a) It is the intent of the General Assembly to enact legislation, no later than March 15, 2019, that will ensure that the premium tax levied under G.S. 105-228.5 applies to capitation payments received by Prepaid Health Plans, as defined in G.S. 58-93-2, in the same manner in which the tax is applied to the gross premiums from business done in this State for all other health care plans and contracts of insurance provided by insurers or health maintenance organizations subject to the tax.

SECTION 8.(c) By October 1, 2018, the Department of Health and Human Services, in consultation with the Department of Revenue, shall submit a report to the Joint Legislative Oversight Committee on Medicaid and NC Health Choice containing proposed legislative changes necessary to accomplish the intent set forth in subsection (a) of this section. The report shall include the following:

- (1) Assurances that the proposed legislative changes do not violate federal Medicaid laws or regulations.
- (2) An estimate of the amount of increase in revenue that is anticipated as a result of the proposed legislative changes, and any proposed uses for the increase in revenue.

Attachment B: Proposed Legislative Changes

Chapter 105 Taxation Article 8B. Taxes Upon Insurance Companies.

SECTION 1. Article 8B of Chapter 105 of the General Statutes reads as rewritten:

“§ 105-228.3. Definitions.

The following definitions apply in this Article:

- (1) Article 65 corporation. – A corporation subject to Article 65 of Chapter 58 of the General Statutes, regulating hospital, medical, and dental service corporations.
- (1a) Captive insurance company. – Defined in G.S. 58-10-340.
- (2) Insurer. – An insurer as defined in G.S. 58-1-5 or a group of employers who have pooled their liabilities pursuant to G.S. 97-93 of the Workers' Compensation Act.
- (2a) Prepaid Health Plan. – As defined in Session Law 2015-245, s. 4(2), as amended.
- (3) Self-insurer. – An employer that carries its own risk pursuant to G.S. 97-93 of the Workers' Compensation Act.

...

“§ 105-228.5. Taxes measured by gross premiums.

(a) Tax Levied. - A tax is levied in this section on insurers, Article 65 corporations, health maintenance organizations, prepaid health plans, and self-insurers. An insurer, health maintenance organization, prepaid health plan, or Article 65 corporation that is subject to the tax levied by this section is not subject to franchise or income taxes imposed by Articles 3 and 4, respectively, of this Chapter.

(b) Tax Base. -

- (1) Insurers. - The tax imposed by this section on an insurer, ~~or a health maintenance organization, or a prepaid health plan~~ shall be measured by gross premiums from business done in this State during the preceding calendar year.
 - (2) Repealed by Session Laws 2006-196, effective for taxable years beginning on or after January 1, 2008.
 - (3) Article 65 Corporations. - The tax imposed by this section on an Article 65 corporation shall be measured by gross collections from membership dues, exclusive of receipts from cost plus plans, received by the corporation during the preceding calendar year.
 - (4) Self-insurers. - The tax imposed by this section on a self-insurer shall be measured by the gross premiums that would be charged against the same or most similar industry or business, taken from the manual insurance rate then in force in this State, applied to the self-insurer's payroll for the previous calendar year as determined under Article 2 of Chapter 97 of the General Statutes modified by the self-insurer's approved experience modifier.
- (b1) Calculation of Tax Base. - In determining the amount of gross premiums from business in this State, all gross premiums received in this State, credited to policies written or procured in this State, or derived from business written in this State shall be deemed to be for

contracts covering persons, property, or risks resident or located in this State unless one of the following applies:

- (1) The premiums are properly reported and properly allocated as being received from business done in some other nation, territory, state, or states.
- (2) The premiums are from policies written in federal areas for persons in military service who pay premiums by assignment of service pay.

Gross premiums from business done in this State in the case of life insurance contracts, including supplemental contracts providing for disability benefits, accidental death benefits, or other special benefits that are not annuities, means all premiums collected in the calendar year, other than for contracts of reinsurance, for policies the premiums on which are paid by or credited to persons, firms, or corporations resident in this State, or in the case of group policies, for contracts of insurance covering persons resident within this State. The only deductions allowed shall be for premiums refunded on policies rescinded for fraud or other breach of contract and premiums that were paid in advance on life insurance contracts and subsequently refunded to the insured, premium payer, beneficiary or estate. Gross premiums shall be deemed to have been collected for the amounts as provided in the policy contracts for the time in force during the year, whether satisfied by cash payment, notes, loans, automatic premium loans, applied dividend, or by any other means except waiver of premiums by companies under a contract for waiver of premium in case of disability.

Gross premiums from business done in this State in the case of prepaid health plan contracts for the delivery of Medicaid and NC Health Choice services means all capitation payments received by the prepaid health plan during the calendar year.

Gross premiums from business done in this State for all other health care plans and contracts of insurance, including contracts of insurance required to be carried by the Workers' Compensation Act, means all premiums written during the calendar year, or the equivalent thereof in the case of self-insurers under the Workers' Compensation Act, for contracts covering property or risks in this State, other than for contracts of reinsurance, whether the premiums are designated as premiums, deposits, premium deposits, policy fees, membership fees, or assessments. Gross premiums shall be deemed to have been written for the amounts as provided in the policy contracts, new and renewal, becoming effective during the year irrespective of the time or method of making payment or settlement for the premiums, and with no deduction for dividends whether returned in cash or allowed in payment or reduction of premiums or for additional insurance, and without any other deduction except for return of premiums, deposits, fees, or assessments for adjustment of policy rates or for cancellation or surrender of policies.

(c) Exclusions. - Every insurer, in computing the premium tax, shall exclude all of the following from the gross amount of premiums, and the gross amount of excluded premiums is exempt from the tax imposed by this section:

- (1) All premiums received on or after July 1, 1973, from policies or contracts issued in connection with the funding of a pension, annuity, or profit-sharing plan qualified or exempt under section 401, 403, 404, 408, 457 or 501 of the Code as defined in G.S. 105-228.90.
- (2) Premiums or considerations received from annuities, as defined in G.S. 58-7-15.
- (3) Funds or considerations received in connection with funding agreements, as defined in G.S. 58-7-16.
- (4) The following premiums, to the extent federal law prohibits their taxation

under this Article:

- a. Federal Employees Health Benefits Plan premiums.
 - b. Medicaid or Medicare premiums.
- (d) **(See Editor's note)** Tax Rates; Disposition. -
- (1) Workers' Compensation. - The tax rate to be applied to gross premiums, or the equivalent thereof in the case of self-insurers, on contracts applicable to liabilities under the Workers' Compensation Act is two and five-tenths percent (2.5%). The net proceeds shall be credited to the General Fund.
 - (2) Other Insurance Contracts. - The tax rate to be applied to gross premiums on all other taxable contracts issued by insurers, ~~or~~ health maintenance organizations, or prepaid health plans, and to be applied to gross premiums and gross collections from membership dues, exclusive of receipts from cost plus plans, received by Article 65 corporations is one and nine-tenths percent (1.9%). The net proceeds shall be credited to the General Fund, except for proceeds paid by prepaid health plans. The net proceeds paid by prepaid health plans shall be credited to a fund to be used to support the Medicaid and NC Health Choice programs in this State that may only be used by the North Carolina Department of Health and Human Services pursuant to an appropriation by the General Assembly.

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SECTION 2. Section 105-259 of the General Statutes reads as rewritten:

“§ 105-259. Secrecy required of officials; penalty for violation.

...

(b) Disclosure Prohibited. - An officer, an employee, or an agent of the State who has access to tax information in the course of service to or employment by the State may not disclose the information to any other person except as provided in this subsection. Standards used or to be used for the selection of returns for examination and data used or to be used for determining the standards may not be disclosed for any purpose. All other tax information may be disclosed only if the disclosure is made for one of the following purposes:

...

(49) To exchange information concerning a tax imposed by Article 8B of this Chapter with the North Carolina Department of Insurance or the North Carolina Department of Health and Human Services when the information is needed to fulfill a duty imposed on the Department.

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